

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
INTERNATIONAL ENHANCED INDEX STRATEGY – EXTERNALLY
MANAGED

February 14, 2006

This Policy is effective immediately upon adoption.

I. PURPOSE

This document sets forth the investment policy (“the Policy”) for the Externally Managed International Enhanced Indexing Program (“the Program”). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees’ Retirement System (“the System”) take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the international capital markets.

II. STRATEGIC OBJECTIVE

Providing consistent excess returns above international equity markets while controlling risk is the strategic objective for the Program.

The Program shall be managed to accomplish the following:

- A. Diversify the System’s overall Equity Program by complementing the Passive and Active International Equity Programs;
- B. Enhance the expected return of the System’s investment program;
- C. Hedge against active member (pre-retirement) liabilities; and
- D. Consider solely the interests of the System’s participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES AND DELEGATIONS

- A. The **System’s Investment Committee** (“the Investment Committee”) is responsible for approving and amending the Policy. The Committee delegates the responsibility for administering the

Program to the Investment Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).

B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee.
2. Developing and maintaining a procedures manual, subject to periodic review and updating, that outlines Staff operational procedures used in implementing this Policy.
3. Implementing and adhering to the Policy.
4. Recommending action concerning outside money management firm(s) ("Managers") retained under contract to implement the Program. The Staff shall make recommendations in accordance with the Manager Monitoring – Externally Managed Policy, regarding changes in the Manager's contractual guidelines, and any other aspect Staff considers pertinent.
5. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall monitor the implementation of, and compliance with, the Policy. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately and in writing to the Investment Committee. Such reports to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action.

C. **Managers** are responsible for all aspects of portfolio management as set forth in Manager's contract with the System and shall fulfill the following duties:

1. Communicate with the System's Staff, as needed, regarding investment strategies and results. The Investment Committee and Staff expect Managers to monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.
2. Cooperate fully with the System's Staff, Custodian, and General Pension Consultant concerning requests for information.

- D. The **General Pension Consultant** is responsible for monitoring and evaluating each Manager's performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

IV. PERFORMANCE OBJECTIVE

The Program shall use an appropriate international large capitalization core equity index for a benchmark and shall produce an excess return, net of fees and costs, of 1.00% per annum with an annual tracking of 2.00%-2.50%. The Program shall contribute positively to the excess return results of the International Equity Program by exceeding the return of the CalPERS Custom FTSE Developed World Ex.-U.S. Index.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approaches

1. Acceptable investment approaches shall include equity-based strategies.
 - a. Enhanced index international equity-based strategies shall be selected for their ability to consistently add value above an appropriate benchmark on a risk-controlled basis, defined as having a tracking error that is below traditional active management.
2. The Program shall be implemented through the retention of external managers. External manager selection shall occur in accordance with Section V.B. of this Policy.
3. The System shall continually review the viability of the program, conducting a formal review at least every five (5) years.

B. External Manager Selection

1. The System shall retain *equity-based* managers that have recognized expertise in the analysis and selection of international equity securities or approved derivatives. The selected managers shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.

2. The System shall select the managers in accordance with the Contract and Procurement Policy.

C. Investment Parameters

The Managers shall operate under a set of specific guidelines that outlines their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, benchmark, and performance objectives.

Implementation of this Program shall comply at all times with the System's investment policies including, but not limited to, the following parameters:

1. Statement of Derivatives Investment Policy for External Money Managers;
2. Proxy Voting Policies;
3. Manager Monitoring – Externally Managed Policy; and
4. Manager-specific Investment Management Guidelines.

VI. GENERAL

Investors, managers, consultants, or other participants selected by the System shall base all calculations and computations on market value as recorded by the System's Custodian.

VII. GLOSSARY OF TERMS

Definitions for key words used in this policy are located in the Equities Glossary of Terms which is included in the System's Master Glossary of Terms.

Approved by the Policy Subcommittee: December 9, 2005

Adopted by the Investment Committee: February 14, 2006

Asset Class Glossary: Equities
Policy: International Enhanced Index Strategy - Externally Managed
February 14, 2006

Custodian

A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.

Equity Based Strategy

Combination of active stock selection with risk mechanism designed to minimize tracking error relative to the benchmark. Seek to add value through minor variances relative to the market in sector/industry weightings, style (growth/value) tilts or stock weightings. Key inputs into the process come from either analysts' fundamental research or quantitative models.

External Manager

An outside money management firm retained under contract by CalPERS.